INDEX

CITATIONS

CASES

ADMINISTRATIVE DECISIONS

Page

STATUTES

IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

NO. 72-1490

FEDERAL POWER COMMISSION, *Petitioner*

v.

TEXACO INC., ET AL.

NO. 72-1491

DUDLEY T. DOUGHERTY, ET AL., CO-EXECUTORS OF THE ESTATE OF MRS. JAMES R. DOUGHERTY, ET AL., *Petitioners*

v.

TEXACO INC., ET AL.

On Writs Of Certiorari To The United States Court Of Appeals For The District Of Columbia Circuit

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BRIEF OF RESPONDENT TEXACO INC.

INTRODUCTORY STATEMENT

Texaco Inc. (Texaco) adopts the descriptions of opinions below, jurisdiction and statutes involved, contained

in the briefs of the Federal Power Commission (Commission) and Dudley T. Dougherty, *et al.*

COUNTERSTATEMENT OF QUESTIONS PRESENTED

(1) Whether the Federal Power Commission has the power under the Natural Gas Act to exempt from direct rate regulation certain producers of natural gas.

(2) Whether the orders of the Federal Power Commission, exempting certain producers of natural gas from direct rate regulation under the Natural Gas Act, unlawfully discriminate against those natural gas producers whose interstate gas sales remain fully regulated by the Commission.

COUNTERSTATEMENT OF THE CASE

Texaco hereby submits its brief, supporting the decision of the court of appeals below, which found to be unlawful the Commission's attempt at exemption of small producers from direct rate regulation under the Natural Gas Act.[1] Texaco is a producer and seller of substantial quantities of natural gas in interstate commerce which gas sales are regulated by the Commission. Texaco actively competes at all levels with other natural gas producers. Texaco was aggrieved, therefore, by the Commission's discriminatory and unlawful orders described below.

In its Notice of Proposed Rulemaking issued July 28, 1970, in Docket No. R-393 (35 Fed. Reg. 12,220) the Commission proposed to exempt from regulation under the Natural Gas Act all existing and future jurisdictional

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1. 15 U.S.C. §§717 *et seq.*

natural gas sales made by small producers. A small producer was defined as a producer whose total jurisdictional natural gas sales nationwide do not exceed ten million Mcf per year. Comments were filed by interested parties (see App. 14-96) and a conference was held (App. 97-134). On March 18, 1971, the Commission issued its Order No. 428 (App. 135-154) where, *inter alia,* it exempted small producer sales from the direct rate regulatory requirements of Sections 4 and 5 of the Natural Gas Act. Applications for rehearing were filed by various parties which were, in essence, denied by the Commission in its Order No. 428-B, issued July 15, 1971 (App. 242-243).

In its original Notice of Proposed Rulemaking issued July 23, 1970, the Commission proposed to exempt small producers from rate regulation under the Natural Gas Act permitting them to collect their contractually authorized prices for their interstate gas sales. The Commission, however, proposed to continue its regulation under Section 7(b) of the Act stating that small producers would not be permitted to abandon their sales without Commission approval. Additionally, certain reporting requirements were suggested.

In its Order No. 428 the Commission generally followed the proposal set forth in its Notice of Proposed Rulemaking with respect to exemption of small producers from rate regulation. However, the Commission incorporated certain new features not previously proposed whereby the interstate purchaser of a small producer's gas would assume certain regulatory burdens including the responsibility for filing with the Commission its contract with the small producer. Additionally, the Commission indicated that indirect rate regulation of the small pro-

ducer's sales would be accomplished by reviewing the price paid by the pipeline purchaser. If such price failed to meet specified criteria as set forth by the Commission then it would be disallowed in the pipeline's purchased gas cost, resulting in lower rates to the pipeline's customers.

On July 15, 1971, several parties filed in the United States Court of Appeals for the District of Columbia Circuit their petitions for review of Order Nos. 428, 428-A and 428-B. These orders of the Commission were reversed by the court of appeals on December 12, 1972 (Opinion reported at 474 F.2d 416). The court held that the Commission was without authority to exempt small producers from the mandatory requirement of the Natural Gas Act that the rates of all natural gas companies must be regulated directly by the Commission.

ARGUMENT

The Federal Power Commission Does Not Have The Authority To Exempt Small Producers From Direct Rate Regulation Under The Natural Gas Act And In So Doing Has Unlawfully Discriminated Against Other Producers

I. The Commission Has No Power To Exempt Small Producers From The Mandatory Rate Regulatory Provisions Of The Natural Gas Act

As stated in its brief opposing petitions for writs of certiorari filed in this cause, Texaco fully supports the concept of deregulation of *all* natural gas producer sales in interstate commerce. However, the construction of the language of the Natural Gas Act by this Court in the "first *Phillips* case," *Phillips Petroleum Company v. Wisconsin,* 347 U.S. 672 (1954), established the rule that

all producers' sales in interstate commerce must be regulated by the Commission. The above decision and subsequent decisions lead Texaco to believe that relief from direct rate regulation under the mandatory provisions of Section 4 of the Act of any natural gas producer (or "class" of producers) can be granted only by Congress, rather than the Commission.

As stated by the court of appeals decision below at 474 F.2d 419:

> "Ever since Phillips Petroleum Co. v. Wisconsin, the Commission, even against its own will, has had a judicially recognized duty to assume 'jurisdiction over the rates of *all* wholesales of natural gas in interstate commerce"[11] to insure that all such rates comply with the statutory standard.
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> 11. 347 U.S. 672, 682, 74 S.Ct. 794, 799, 98 L.Ed. 1035 (1954). (Emphasis added.) It should be noted that Justice Clark, in dissent, conceded that '[o]n its face, this language brings every gas operator, *from the smallest producer to the largest pipeline*, under federal regulatory control,' 347 U.S. 672, 691, 74 S.Ct. 794, 804 (emphasis added)."

The Commission in exempting the small producer from its rate regulatory jurisdiction relied upon Sections 4, 5, 7 and 16 of the Act. These provisions, however, do not afford the Commission any discretion as to which natural gas producers it may regulate and which natural gas producers it may not regulate. For instance, Section 4(a) of the Act states in part that "*all* rates and charges" by "*any* natural gas company shall be just and reasonable." Section 4(c) of the Act also states that "[u]nder such rules and regulations as the Commission may prescribe, *every* natural-gas company shall file . . . in such form as the Commission may designate, . . . *all* rates and charges

. . ." (emphasis added). While it is recognized that Section 16 of the Act provides that ". . . the Commission may classify persons and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters," it is clear that classification of producers for regulatory purposes is an entirely different matter from exemption of certain producers from such regulation, especially in view of the mandatory language of Section 4 of the Act. Concurring with this analysis, the court of appeals in the present case stated:

> "However, the FPC must act 'within the ambit of [its] . . . statutory authority.' The Commission may not ignore the command of Section 4 (15 U.S.C. § 717 c (a)) . . ." (474 F.2d 419) (note omitted)

The Commission and the courts since the outset of the Commission's regulation of natural gas producers following the previously mentioned "first *Phillips* case" have considered and rejected the total exemption of the small producer. Thus, in adopting regulations to implement its regulation of producers following the *Phillips* case the Commission rejected the suggestion of exemption of small producers.[2]

Several years later the argument of exemption of small producers was likewise rejected in *Saturn Oil & Gas Co. v. Federal Power Commission,* 250 F.2d 61 (10th Cir. 1957), *cert. denied* 355 U.S. 956, wherein the court stated:

> "There is nothing in the Natural Gas Act which makes its applicability depend on the size or the

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2. Order No. 174-B, Docket Nos. R-138, R-137, 13 F.P.C. 1576, 1577 (1954).

integration of the gas operator. The Phillips decision holds that the Act applies to all wholesales by producers. Saturn may not escape regulation because of its size or because of the restricted nature of its operations." (250 F.2d at 67)

In considering this question in its first area rate proceeding, the Commission in *Permian* recognized the legal impediments to exemption of small producers and concluded that it was not "necessary or desirable to provide outright exemption."[3] The Commission, however, exercised its permissible authority under Section 16 of the Act to classify certain small producers for the purpose of applying different regulatory standards to such producers. This approach, which was not the equivalent of exemption from rate regulation, was all that was approved by the Supreme Court in its *Permian* decision (*Permian Basin Area Rate Cases*, 390 U.S. 747, 784-87 (1968)). As pointed out by the court of appeals in the present case at 474 F.2d 420, "the 'exemptions' approved there were from detailed filing requirements, not from all regulation."

In support of its exemption of small producers the Commission has relied upon the suggestion made by Justice Clark in *F.P.C. v. Hunt*, 376 U.S. 515, 527 (1964). The *Hunt* case, which involved the Commission's power to condition a producer's temporary certificate, did not involve questions of exemption of any producers. The Court, however, was concerned over administrative delays in issuing permanent certificates to producers; hence Justice Clark's suggestion that the Commission investigate clearing its backlog of cases by exemption procedures

3. *Area Rate Proceeding (Permian Basin Area)*, Docket Nos. AR61-1, *et al.*, Opinion No. 468, 34 F.P.C. 159 (1965).

such as utilized by the National Labor Relations Board. Ostensibly in support of his suggestion, Justice Clark cited *Guss v. Utah Labor Relations Board*, 353 U.S. 1, 3-4 (1957).

A review of the National Labor Relations Act[4] and the Fair Labor Standards Act[5] under which the exemption practices referred to by Justice Clark were effected shows that the National Labor Relations Board's jurisdiction is discretionary not mandatory. In the *Guss* case cited by Justice Clark, the Court found that these labor acts give the Board extensive jurisdiction over labor controversies affecting interstate commerce but *do not require* the Board to assert at all times the full measure of its jurisdiction. Thus, the Board, is "empowered" but is not "directed" to prevent unfair labor practices (29 U.S.C. § 160(a)). Likewise, the Board is given the "power" rather than the "duty" to issue complaints upon the receipt of appropriate charges (29 U.S.C. § 160(b)). These discretionary powers of the Board are simply not comparable with the mandatory rate provisions of the Natural Gas Act and may not be used as the basis for exemption of any class of producers from direct rate regulation.

The court of appeals in this case fully agreed with the above analysis, and stated at 474 F.2d 420:

> "Only this year the Supreme Court specifically contrasted the FPC and the NLRB, suggesting that the former's jurisdiction will be broadly construed so that there are no 'gaps' in the Natural Gas Act's

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4. 29 U.S.C. §§151, *et seq.*

5. 29 U.S.C. §201.

'comprehensive and effective regulatory scheme."[13] Further, the trials and experimentations which this court has previously approved have always been trials of new procedures consistent with the terms of the Natural Gas Act, not experimental attempts to amend, avoid or ignore these provisions.[14]

13. FPC v. Louisiana Power & Light Co., 406 U.S. 621, 631, 92 S.Ct. 1827, 32 L.Ed.2d 369 (1972).

14. Deregulation is decidedly not one of the 'policy decisions of the type [the FPC] . . . was created to make.' See Public Service Commission v. FPC, 467 F.2d 361, 367."

Having demonstrated above that exemption of any class of producer from direct rate regulation is unlawful, it is unnecessary to speculate on the effectiveness of the scheme of admittedly "indirect review" (Commission's Brief, p. 10) which is advocated at pages 15-20 of the Commission's brief as a means of insuring consumer protection.

II. The Commission's Orders Exempting Small Producers Unlawfully Discriminate Against Large Producers

The Commission in Order No. 428 classified all regulated independent producers into two categories; those having total interstate gas sales to and including ten million Mcf annually and those whose interstate sales are in excess of ten million Mcf per year. Texaco, which falls into the latter, nonexempt group, submits that there is no factual basis for such a distinction.

All producers irrespective of their size compete directly with one another at all levels of the natural gas industry. When the Commission by its orders frees a certain segment of the natural gas producing industry from rate

regulation, such producers immediately acquire an unfair advantage in this highly competitive enterprise. An example of the competitive advantage enjoyed by a nonregulated producer is in the acquisition of leases. A landowner logically has no preference between those bidding to lease his mineral rights based on the size of the potential lessee's interstate gas sales. What is likely to influence the lessor's decision is the fact that if natural gas is found on his property, the lessee may sell such gas at prices in excess of the Commission's established area ceiling rate if the lessee is a "small producer."

An undue preference or advantage to the exempt producers is unlawful under the terms of Sections 4(b) and 5(a) of the Act.[6] Section 4(b) requires that the Commission in its rate regulation not permit the granting of "any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage."[7] Section 5(a) similarly obligates the Commission to correct any situation where it finds "that any rule, regulation, practice, or contract affecting [a] rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential. . . ."[8]

In *Episcopal Theological Seminary v. Federal Power Commission*, 106 U.S. App. D.C. 37, 269 F.2d 222 (1959), *cert. denied* 361 U.S. 895 the court recognized that the Commission could not discriminate in its rate treatment between producers which sold jurisdictional gas under similar circumstances. That case involved an issue

6. 15 U.S.C. §§717c(b) and 717b(a).

7. 15 U.S.C. §717c(b).

8. 15 U.S.C. §717d(a).

as to whether rate increases by certain producers in a gas field from 13 cents per Mcf to 13.5 cents per Mcf were "just and reasonable" under Section 4 of the Act. One of the arguments raised by the producers was that the Commission in an earlier order, had found that an increase to 13.5 cents per Mcf in the same field by another producer was just and reasonable. The court observed that the Commission could not permit one producer in the field to collect the 13.5 cents rate while denying it to others. As the court stated:

> "Obviously, any such arbitrary differentiation without any distinction as to the proceeding is not permissable.[28]
>
> 28. Cf. Atlantic Seaboard Corp. v. Federal Power Comm., 4 Cir., 201 F.2d 568, 570." (269 F.2d at 237)

The court went on, however, to note that the Commission had already undertaken to "correct" its error in permitting the 13.5 cents rate to be collected by the institution of a rate investigation under Section 5(a) of the Act. This case clearly establishes that producers must be afforded rate regulation on a uniform and nondiscriminatory basis.[9]

Texaco, therefore, submits that the Commission has abused its discretion in promulgating an order which, contrary to the provisions of Sections 4(b) and 5(a) of the Act, unfairly discriminates against large producers. In view of the fact that the first portion of the argument in this brief demonstrates the Commission's efforts to dis-

9. *Also see Federal Trade Commission v. Crowther*, 139 U.S. App. D.C. 137, 430 F.2d 510 (1970) where the court reversed an agency decision which involved unequal regulatory treatment between parties in virtually identical circumstances.

regard the mandatory provisions of the Act, such abuse of discretion is particularly cognizable by the Court when the Commission's action on its face is unlawful (Cf. *Scanwell Laboratories, Inc. v. Shaffer*, 137 U.S. App. D.C. 371, 424 F.2d 859 (1970)).

CONCLUSION

For the reasons stated above, the judgment of the court of appeals, invalidating the small producer exemption, should be affirmed.

Respectfully submitted,

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